

5. The lack of competitive pressures in the market for special access and dedicated transport is further reflected in BellSouth's pricing behavior. Although BellSouth is free to set its rates for these services at any level as long as they do not exceed the applicable price cap ceiling, BellSouth has consistently priced these services at or near the price cap level. For special access services and channel terminations provided to end users, BellSouth's price cap index is 58.0507, and its actual price index is 58.0444. For high capacity dedicated transport, BellSouth's service band index upper limit is 66.3127, and its actual service band index is 63.1550.²

6. Furthermore, although the Commission's *Pricing Flexibility Order* gave price cap ILECs the flexibility to deaverage special access and dedicated transport rates into seven zones per study area, BellSouth has not done so. Instead, BellSouth's prices for special access and dedicated transport are identical, or virtually identical, in all three rate zones, which represent the degree of deaveraging permitted for these services within a study area under earlier Commission orders issued before the *Pricing Flexibility Order*. For example, BellSouth's DS-3 rates are identical across Zones 1, 2 and 3 in every study area. BellSouth's DS-1 channel termination rates show only slight variation across zones, with Zone 1 at \$150, Zone 2 at \$156, and Zone 3 at \$161 in every study area.

7. Some CLECs have made efforts to enter the market for special access services and dedicated transport as alternatives to BellSouth as a provider of these services. The availability of these providers, however, remains extremely limited. As previously stated, despite AT&T's attempts to find lower-cost providers of these services, only REDACTED percent of AT&T's payments for these services went to providers other than BellSouth.

² These price cap indices were obtained from BellSouth Transmittal No. 558, filed July 27, 2000 and effective August 11, 2000, TRP IND-1, lines 899, 340.

8. BellSouth also dominates the market for channel terminations.

Approximately REDACTED percent of AT&T's expenses for channel terminations in the BellSouth region are made to BellSouth.

B. Switched Access Services

9. There is similarly little competition in the market for switched access services in the BellSouth region. For example, in the MSAs that are the subject of BellSouth's petition for pricing flexibility in CCB/CPD File No. 00-21, AT&T makes REDACTED percent of its switched access payments to BellSouth itself, and only REDACTED percent of those payments to other providers of switched access.

10. Like its pricing of special access and dedicated transport, BellSouth's pricing of switched access services reflects the lack of effective alternative providers – and the absence of competitive pressures on BellSouth's pricing. For common line services, all of BellSouth's prices for SLC rates, PICC rates and CCL rates are set at the maximum allowable level. For traffic-sensitive services, BellSouth's price cap index is 34.2184, and its actual price index is 34.2150. For tandem-switched services, BellSouth's service band index upper limit is 106.1760, and its actual service band is 104.0941.³

11. BellSouth also has failed to take advantage of the flexibility granted in the *Pricing Flexibility Order* to deaverage tandem-switched transport rates into seven zones per study area. Indeed, BellSouth's rates for tandem-switched transport and tandem switching are identical in all three rate zones in each of the five study areas where BellSouth has sought pricing flexibility for switched access services. Those rates represent the degree of deaveraging within a study area allowed by the Commission prior to the *Pricing Flexibility Order*.

³ See BellSouth Transmittal No. 558, *supra*, TRP IND-1, lines 299, 310.

12. The perversity of the Commission's switched access trigger is dramatically underscored by the fact that, although some of the CLECs that BellSouth cites in its pricing flexibility petition charge rates that are lower than those offered by BellSouth, many of them charge rates that are *higher* than BellSouth's. Currently, BellSouth's average interstate originating switched access rate is \$0.0057260 per minute, and its average interstate terminating switched access rate is \$0.0055000 per minute. As shown in the chart below, AT&T is in some instances billed per-minute rates by these "competitive" providers that are several multiples *above* BellSouth's rates.

CLEC	State	Interstate	Interstate
		Originating	Terminating
Allegiance Telecom	GA	\$0.0584720	\$0.0563520
American Metrocomm	LA	\$0.0414460	\$0.0595730
Business Telecom	FL	\$0.0754970	\$0.0718230
	GA	\$0.0767670	\$0.0767670
	SC	\$0.0747190	
Florida Digital	FL	\$0.0450010	\$0.0450010
HTC (Horry Tel)	SC	\$0.0259040	\$0.0426660
ICG	AL	\$0.0222900	\$0.0222900
	GA	\$0.0218110	\$0.0218110
ICI	FL	\$0.0464130	\$0.0452800
	GA	\$0.0464180	
New South Communications	AL	\$0.0771107	\$0.0769230
	FL	\$0.0771107	\$0.0769230
	GA	\$0.0771107	\$0.0769230
	LA	\$0.0771107	\$0.0769230
	SC	\$0.0780180	\$0.0832130
Nextlink	FL	\$0.0379370	\$0.0379370
	GA	\$0.0309330	\$0.0309330
Orlando Tel. Co.	FL	\$0.0391600	\$0.0391600
Shell Offshore Svc. Co.	LA	\$0.0413200	\$0.0574090
Universal Comm.	FL	\$0.0334434	\$0.0405417
Z-Tel	FL	\$0.0300000	\$0.0294900

II. ALLOWING PRICE CAP LECs THE PRICING FLEXIBILITY AUTHORIZED BY THE *PRICING FLEXIBILITY ORDER* WOULD CAUSE IRREPARABLE INJURY TO AT&T.

13. The scope of the deregulation that BellSouth and other price cap LECs would achieve if its petitions were granted is immense. For example, a comparison of the MSA-level revenue data provided by BellSouth pursuant to the Commission's protective order in CCB/CPD File Nos. 00-20 and 00-21 with other publicly available data indicates that, if BellSouth were granted the Phase II pricing flexibility that it requests in its petition regarding special access and dedicated transport, REDACTED BellSouth's interstate special access and dedicated transport revenues would be removed from price cap regulation. This amount represents approximately REDACTED percent of BellSouth's interstate revenues of \$1.033 billion for these services.⁴ Approximately REDACTED percent of BellSouth's switched access revenues would be subject to Phase I pricing flexibility if its petition were granted.

14. The price structure that the Commission required price cap LECs to follow before issuance of the *Pricing Flexibility Order* has afforded important protections to alternative access providers (both actual and potential) and to purchasers of access services. The price cap rate structure set a ceiling on access charges, in order to prevent the LEC from imposing monopoly prices on its access customers. Restrictions on geographic deaveraging limited a price cap LEC's ability to set prices at discriminatory levels to eliminate or prevent competition. Prior to the *Pricing Flexibility Order*, ILECs were permitted to deaverage special access, dedicated transport and tandem-switched service rates across only three rate zones per study area – and could do so only upon a showing that the zones reflected cost characteristics such as traffic

⁴ Compare Phase II revenue data in Attachment 2 to BellSouth's petition in CCB/CPD File No. 00-20 (proprietary version) with total revenue data per BellSouth transmittal No. 558, filed July 27, 2000 and effective August 11, 2000.

density or other measures of traffic passing through particular central offices. The Commission's rules did not permit deaveraging of switched access services.

15. Phase I of the pricing flexibility authorized by the Commission, however, would allow a price cap LEC such as BellSouth to give volume and term discounts and to file contract tariffs (which would be exempt from price cap regulation). Phase II relief would eliminate price caps – thus allowing price cap LECs to charge rates higher than the current ceilings. These forms of relief would apply to any MSA as to which the LEC satisfied the applicable triggers, even in portions of the MSA where no alternative access provider exists. Moreover, the *Pricing Flexibility Order* permits price cap LECs to deaverage special access, dedicated transport and tandem-switched service rates across a maximum of seven rate zones, without any cost or competitive showing – and without the need for prior Commission approval. Using these various new forms of pricing flexibility, a LEC could charge different access rates, at any price level, in different geographic areas.

16. As Professor Willig describes in his Declaration, a price cap LEC with market power in the MSA, if granted pricing flexibility relief, would therefore have the ability to use a combination of predatory pricing and monopoly pricing to impede competition and increase its revenues. If a price cap LEC such as BellSouth could engage in this behavior, AT&T and other customers of access services would be irreparably harmed.

17. First, given the general lack of competition in the provision of access services in most areas of its region, BellSouth would have a strong incentive to increase its charges for access services substantially above price cap levels. As a result, AT&T would have little choice but to pass on the increase to its long-distance customers in the form of higher rates to cover the resulting increase in its costs, given the low profit margins in the long-distance

market. Consumers would likely react by reducing their demand for AT&T's long-distance service, and AT&T would experience substantial reductions in its customer base and its revenues as a result. These customer and revenue losses would worsen dramatically once BellSouth receives authority under Section 271 of the Telecommunications Act of 1996 to provide in-region interLATA service in competition with AT&T and other interexchange carriers, for the reasons described in Professor Willig's Declaration. It is AT&T's understanding that BellSouth intends to file a Section 271 application with this Commission during the first or second quarter of 2001 and to file similar applications for the other states in its region once the initial application is approved.

18. Second, BellSouth's use of predatory pricing to impair or eliminate existing alternative providers of access services will deter entry by other parties into the market, thereby depriving AT&T (and the market) of additional alternative access providers. For the reasons stated in Professor Willig's Declaration, BellSouth would be able to deter prospective entrants by using (or threatening to use) predatory pricing practices against any competitor, because the entrant would have virtually no prospect of recovering its costs. Thus, in lieu of the potential for lower prices and higher-quality services that competition creates, AT&T would be faced with higher access charges, increased costs, and loss of a substantial portion of its long-distance business.

19. Third, by deterring entry of alternative access providers, BellSouth's predatory pricing practices would deny AT&T potential customers of its excess long-distance capacity. Although CLECs provide access services in their capacity as local exchange carriers, many of these CLECs also offer interexchange service – which they provide through excess long-distance capacity that they purchase from AT&T. AT&T receives substantial revenues

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FOR PUBLIC INSPECTION

from these sales of excess capacity. Thus, the exclusion of prospective alternative access providers from the market means a corresponding lost business opportunity for AT&T.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

Executed on this 21st day of November, 2000.

Charles E. Stock
Charles E. Stock

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review for Local Exchange Carriers)	CC Docket No. 94-1
)	
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers)	CCB/CPD File No. 98-63
)	
BellSouth Telecommunications, Inc.'s Petition for Pricing Flexibility for Special Access and Dedicated Transport)	CCB/CPD File No. 00-20
)	
BellSouth Telecommunications, Inc.'s Petition for Pricing Flexibility for Switched Access)	CCB/CPD File No. 00-21
)	

**DECLARATION OF ROBERT D. WILLIG
ON BEHALF OF AT&T CORP.**

Robert D. Willig does hereby depose and state as follows:

1. My name is Robert D. Willig. I am Professor of Economics and Public Affairs at the Woodrow Wilson School and the Economics Department of Princeton University, a position that I have held since 1978. Before that, I was Supervisor in the Economics Research Department of Bell Laboratories. My teaching and research have specialized in the fields of industrial organization, government-business relations and welfare theory.

2. I served as Deputy Assistant Attorney General of Economics in the Antitrust Division of the United States Department of Justice from 1989 to 1991. I also served on the Defense Science Board task force on the antitrust aspects of defense industry consolidation and on the Governor of New Jersey's task force on the market pricing of electricity.

3. I am the author of *Welfare Analysis of Policies Affecting Prices and Products*, *Contestable Markets and the Theory of Industry Structure* (with W. Baumol and J. Panzar), and numerous articles, including "Merger Analysis, IO theory, and Merger Guidelines." I am also a co-editor of *The Handbook of Industrial Organization*, and have served on the editorial boards of the *American Economic Review*, the *Journal of Industrial Economics* and the MIT Press Series on regulation. I am an elected Fellow of the Econometric Society and an associate of The Center for International Studies.

4. I have been active in both theoretical and applied analysis of telecommunications issues. Since leaving Bell Laboratories, I have been a consultant to AT&T, Telstra and New Zealand Telecom, and have testified before the U.S. Congress, the Federal Communications Commission, and the public utility commissions of about a dozen states. I have been on government and privately supported missions involving telecommunications throughout South America, Canada, Europe, and Asia. I have written and testified on such subjects within telecommunications as the scope of competition, end-user service pricing and costing, unbundled access arrangements and pricing, the design of regulation and methodologies for assessing what activities should be subject to regulation, directory services, bypass arrangements, and network externalities and universal service. On other issues, I have worked as a consultant with the Federal Trade Commission, the Organization for Economic Cooperation and Development, the Inter-American Development Bank, the World Bank and various private clients. A full list of

my articles and other professional publications and activities is presented in my *curriculum vitae*, which is attached hereto as Attachment 1.

PURPOSE AND SUMMARY OF TESTIMONY

5. The purpose of my testimony is twofold. First, I will discuss whether the “triggers” that the Commission has promulgated in its *Pricing Flexibility Order*¹ as the tests for pricing flexibility comport with the applicable methodological principles that must be followed to ensure that a price cap local exchange carrier (“LEC”), if granted such flexibility, will not be able to exercise market power over the services at issue.² Second, I will discuss the extent to which abuse of this pricing flexibility by a price cap LEC with market power causes irreparable harm to other carriers and to consumers.

6. The triggers established in the *Pricing Flexibility Order* are insufficient to ensure that incumbent LECs (“ILECs”) if granted pricing flexibility, will be unable to exercise market power over access services, whether special access and dedicated transport or switched access. The Commission’s triggers fail to ensure that an ILEC will present specific and verifiable evidence in support of its request for price flexibility, and require no showing that the ILEC lacks market power over any of the critical components of the access services at issue. Furthermore, because they fail to require a showing that the ILEC lacks market power throughout a Metropolitan Statistical Area (“MSA”), the triggers allow an ILEC to be granted

¹ *In the Matter of Access Charge Reform*, CC Docket Nos. 96-262 and 94-1, CCB/CPD File No. 98-63, and CC Docket No. 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, released August 27, 1999 (“*Pricing Flexibility Order*”).

² In this Declaration, I will also use the terms “incumbent local exchange carrier,” or “ILEC,” to refer to price cap LECs.

pricing flexibility even when competition is shown to exist only in *part* of the applicable MSA for which pricing flexibility is requested – and the ILEC can therefore exercise market power over services in the remaining, noncompetitive portions of that MSA. Finally, the Commission's triggers do not take into account the extent to which the ILEC has already taken advantage of currently permitted pricing flexibility to reduce its rates – an important indicator of the actual extent of competition for the services involved.

7. Because of these flaws in the Commission's triggers, price cap LECs who are granted pricing flexibility will be able to use a combination of predatory pricing and monopoly pricing to inflict irreparable harm on competitive providers of access services, purchasers of access services, and consumers of telecommunications services. Where the threat of competitive entry exists, the ILEC will be able to engage in predatory pricing to deter entry. In areas where competition does not exist, the ILEC, freed of price cap ceilings, will have the ability and incentive to raise access charges to monopoly levels, requiring interexchange carriers ("IXCs") to charge higher long-distance rates to their customers (and resulting in substantial losses of revenues and customers to the IXCs). Finally, because additional access providers will be deterred from entering the market, interexchange carriers such as AT&T will lose the opportunity to sell their excess long-distance capacity to such providers, who likely would need such capacity to provide interexchange service.

I. The "Triggers" That the Commission Has Established For Pricing Flexibility Relief Are Inconsistent With Fundamental Methodological Principles That Must Be Applied To Ensure That the Price Cap LEC Will Not Be Able To Exercise Market Power After Such Relief Is Granted.

8. The Commission's *Pricing Flexibility Order* establishes mechanisms by which price cap LECs (*i.e.*, incumbent LECs) can obtain broad deregulation of their interstate

access services (both special access and switched access) throughout an MSA if the LEC makes certain showings of competitive entry within that MSA. The *Order* establishes two “phases” of deregulatory relief. In Phase I, an incumbent LEC may offer contract tariffs and volume and term discounts for those services for which it makes a showing of competitive entry. In Phase II, the incumbent LEC obtains complete removal of the price cap and rate structure rules throughout an MSA if the LEC can demonstrate a somewhat higher level of competitive entry for those services within the MSA. In addition to establishing the Phase I and Phase II mechanisms, the *Order* relaxes the preexisting restrictions on geographic deaveraging, thereby giving the ILECs greater freedom to deaverage rates for certain access services – with no requirement of prior Commission approval.³

9. The Commission stated in the *Pricing Flexibility Order* that it was authorizing this new pricing flexibility in order to advance the pro-competitive, deregulatory national policies embodied in the Telecommunications Act of 1996 (“the 1996 Act”). *Pricing Flexibility Order*, ¶ 1. As an economist, I agree that such deregulation is in the public interest if, in the absence of regulation, the incumbent cannot exercise undue market power, and if the absence of regulation will promote competition in the relevant product and geographic market. However, as the Commission recognized, granting such relief prematurely might enable an incumbent LEC to engage in anticompetitive behavior, including the exclusion of new entrants through monopoly pricing practices. *Id.*, ¶ 68.

³ Generally, prior to the *Pricing Flexibility Order*, the Commission permitted ILECs to deaverage their rates into three density zones per study area upon a showing that the zones represent cost characteristics such as traffic density or other measures of traffic passing through particular central offices. Under the revised regulations promulgated in the *Order*, ILECs may deaverage special access, dedicated transport and tandem-switched transport into as many as 7 rate zones per study area, without a cost or competitive showing. *Pricing Flexibility Order*, ¶¶ 58-59.

10. Such anticompetitive consequences can be avoided only if certain methodological principles are applied in considering an ILEC's request for pricing flexibility. Unfortunately, the "triggers" established by the Commission are inconsistent with those principles.

A. Conditions For Pricing Flexibility

11. Four fundamental methodological principles are critical to a reasoned evaluation of a particular ILEC's request for pricing flexibility for access services, regardless of whether the services at issue are special access and dedicated transport or switched access. Only if these principles are applied can the Commission be reasonably certain that the ILEC, if granted the requested relief, will not be able to exercise market power over the services at issue.

12. *First*, the Commission must require that the ILEC, as the petitioner, bear the burden of proof – the burden to demonstrate with specific and verifiable evidence that it will be unable to exercise incremental market power with respect to any of the targeted access services in the absence of price regulation. This allocation of the evidentiary burden is appropriate, given the clear informational asymmetries with respect to such issues as the locations and capacities the incumbent uses to provide access services, the locations and the extent to which competitors have interconnected to the incumbent's network, and the extent to which purportedly "facilities-based" competitors still rely on components purchased from the ILEC. In this regard, it is particularly important that all evidence and analyses presented by the petitioning ILEC be verifiable, with data sources fully identified, methodologies fully explained, and assumptions fully disclosed. This is so because failure to collect and analyze the relevant data on an appropriately disaggregated basis can lead to inaccurate and misleading conclusions and, ultimately, wrong decisions.

13. *Second*, the Commission must insist that the ILEC show with specificity that it has lost market power with respect to *each critical component* of the services at issue. The importance of this point cannot be overstated. Both economic theory and experience teach that a supplier of a service will have the ability to exercise market power with respect to that service if the supplier maintains market power over a *single* critical input to providing the service – even if the provision of all other components of the service is fully competitive. As long as the ILEC retains monopoly power over any such bottleneck input to access services, it can extract monopoly rents from access customers (or from resellers who must buy the bottleneck inputs from the incumbent).

14. For example, special access services comprise at least two distinct components: local distribution channels (“LDCs”) and dedicated transport. Special access connects a high-volume customer directly from its premises to a long-distance carrier’s point of presence (“POP”).⁴ LDCs, or channel terminations, are the facilities used to connect a special access customer to a local service office (“LSO”). Dedicated transport facilities, which the ILECs further disaggregate into an interoffice transport channel (which connects the LSO to a serving wire center that serves a POP) and entrance facilities (which connect the serving wire center to the POP), carry calls from the LSO to the long-distance carriers’ POP.

15. If competing special access suppliers are to constrain the retail price of special access services to competitive market levels, there must be a competitive supply of *both* of these inputs. For that reason, retail market share figures are meaningless in this context. An unregulated incumbent with *zero* percent of the retail special access services market could nonetheless earn monopoly rents – and ensure that retail special access service prices remain

⁴ The POP is the interconnection point between the local network and the long-distance network.

well above competitive market levels – through its control of one or more of the inputs to those services.

16. To illustrate this point, assume that a customer is willing to pay \$150/month for special access. Assume also that the forward-looking incremental costs for LDC and transport are \$75 and \$25 per month, respectively.⁵ The competitive price for the *service* would be \$100. However, if an ILEC controls the LDC, it can charge \$125 for it and get \$50 in monopoly profit, even if transport were supplied competitively at the competitive price of \$25 per month. Hence, competition in the provision of transport is not sufficient to drive the price of the special access service to the competitive level.

17. *Third*, the Commission must verify that the incumbent's evidence is consistent with the geographic scope of the relief sought in the petition for pricing flexibility. This is because the existence of substantial facilities-based competition in one area cannot constrain prices of access services in another area that is not subject to such competition. Rather, as the Commission has recognized, the services are demanded and provided on a point-to-point basis.⁶ In other words, even if there were multiple facilities-based suppliers of all components of access services in a central business district, that would not constrain an unregulated ILEC's access rates in suburban or rural areas outside the city center where competition is weak or nonexistent. The ILEC must therefore be required to show that it lacks market power over the service in question *throughout* the area for which it seeks relief.

⁵ Here, I am abstracting from complications which arise from the fact that transport is a joint input into the provision of services to many customers.

⁶ See Memorandum Opinion and Order, CC Docket No. 97-211, ¶ 166 (released September 14, 1998) (rejecting use of state-wide geographic markets for exchange access and adopting "point-to-point markets" or markets of "discrete local areas"); Memorandum Opinion and Order in *Application of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee*, File No. NSD-L-96-10, ¶¶ 54-56 (released August 14, 1997).

18. This analysis is not altered by the existence of multi-location customers.

The fact that a customer may have competitive options in one part of a state or MSA will not allow that customer to obtain a competitive price in another location that is not subject to competition. For example, assume that a customer needing special access services has two sites and needs a DS1 channel to each. One site is in the city center where competition from multiple suppliers constrains rates to no more than \$100/month, as compared to a monopoly rate of \$150/month. The other area is served only by the ILEC. Free of regulatory constraints, the ILEC would have an incentive to charge \$100/month in the competitive area (or, perhaps, \$99/month to beat the competition) and \$150/month in the noncompetitive area. Because there is no alternative arrangement through which the customer can obtain better overall rates from another supplier – or combination of suppliers, such as the ILEC in the noncompetitive area and a new entrant in the competitive area – the customer cannot make a credible threat to switch and thus has no “leverage” to force the ILEC to reduce rates in the noncompetitive area. Nor can the customer gain any leverage by requesting statewide or MSA-wide flat-rate prices. The ILEC could then simply offer a contract rate of \$125/month for each of the two DS1 channels. Once again, no alternative supplier could provide a better overall rate or undermine the ILEC’s ability to collect its monopoly rent.

19. Thus, careful evaluation of the evidence submitted by an ILEC may reveal important service components or geographic areas covered by the petition for pricing flexibility for which little competition currently exists and the ILEC clearly remains the dominant provider. Of course, the Commission’s analysis should not be confined to only the levels of existing competition. The ability of an ILEC to exercise market power might also be constrained by potential competition. However, care must be taken to ensure that entry barriers are analyzed

with respect to the relevant discrete service components and geographic areas, and that the analysis be appropriately rigorous and specific. For example, it would clearly be inappropriate to infer from the existence of significant dedicated transport competition, or of entry in the most telecommunications-dense areas of a central business district, that entry barriers for dedicated transport are low in other areas of the same MSA or in *any* area of that MSA for LDCs. Instead, the Commission should require evidence of substantial entry into the provision of the specific access service components and MSAs. Alternatively, the Commission should require specific, verifiable, and conclusive evidence that where entry is not, in fact, occurring, why it would occur in a timely manner or on an efficient scale to render unprofitable any attempt by the ILEC to exercise market power if it were granted pricing flexibility.

20. *Fourth*, in evaluating an ILEC's claims that market forces will constrain its access service prices in the absence of regulation, the Commission should not ignore the available direct evidence of the impact of market forces on the ILEC's pricing behavior, and the extent to which the ILEC has already taken advantage of any pricing flexibility currently permitted by the Commission (*i.e.*, pricing flexibility that the ILEC can currently exercise without obtaining prior Commission approval). For example, where the incumbent's prices for access services remain at or close to regulatory price caps, or the ILEC has not practiced any geographic deaveraging of rates authorized by the Commission, the Commission should require substantial evidence to support claims of price-constraining competition. The price caps for special and switched access were initially established on the basis of historical costs and, I understand, far exceed the forward-looking cost-based rates that would prevail in a truly competitive market. Moreover, even prior to the issuance of the *Pricing Flexibility Order*, ILECs had the flexibility to lower access rates to meet competition and to establish up to three

separate rate zones based on the costs of providing special access, dedicated transport, and tandem-switched services. I also understand that the Commission's preexisting pricing regulations permitted ILECs to offer volume and term discounts for special access and switched transport services upon specific competitive showings, as long as such discounts were made available to similarly situated customers.⁷

21. Accordingly, if ILECs have not taken advantage of the flexibility provided to date by the Commission's pricing regulations to lower rates and "meet the competition," the obvious inference is that they are *not* subject to effective competition over a wide range of customers so that an across-the-board price cut would be unprofitable, and an across-the-board price increase might be profitable, as compared to a possible loss of a few customers. In such a case, granting pricing flexibility would not be in the public interest.

B. The Inadequacies of the Commission's "Triggers"

22. The various "triggers" that the Commission has adopted -- and which ILECs must satisfy -- as prerequisites to pricing flexibility are inconsistent with the four above-described methodological principles. As a result of these deficiencies, the triggers not only fail to protect against the exercise of market power, but could enable an ILEC to exercise market power in substantial portions (even a majority) of an MSA as long as the ILEC can show that competition exists in just a small portion of the MSA.

23. The *Pricing Flexibility Order* establishes separate triggers for different services. With respect to special access services and dedicated transport, Phase I relief is available (except for channel terminations to end users) when a price cap LEC can demonstrate

⁷ Second Report and Order and Third Notice of Proposed Rulemaking, *In the Matter of Expanded Interconnection With Local Telephone Company Facilities*, CC Docket No. 91-141, ¶¶ 87-120 (released September 2, 1993); Report (continued)

that competitors have collocated facilities in 15 percent of its wire centers in an MSA or in wire centers accounting for 30 percent of its revenues from those services in the MSA. Phase II relief is available for those services when competitors have collocated in 50 percent of the price cap LEC's wire centers in an MSA or in wire centers accounting for 65 percent of its revenues from those services in the MSA. Under each of these rules, the *Pricing Flexibility Order* additionally requires price cap LECs to "show that at least one competitor relies on transport facilities provided by a transport provider other than the incumbent at each wire center listed in the incumbent's pricing flexibility petition as the site of an operational collocation arrangement."

Pricing Flexibility Order, ¶ 82. For channel terminations to end users, Phase I relief is available when competitors have collocated in 50 percent of wire centers or in wire centers accounting for 65 percent of revenues. *Id.*, ¶¶ 105-106. Phase II relief is available when competitors have collocated in 65 percent of wire centers or in wire centers accounting for 85 percent of revenues. *Id.*, ¶ 150.

24. For switched access services, the *Pricing Flexibility Order* authorizes price cap LECs to obtain Phase I relief if competing providers of such service offer service, using either their own facilities or their own facilities in combination with unbundled loops, to 15 percent of the customer locations in the relevant MSA. *Id.*, ¶¶ 108, 113. The Commission is still in the process of determining the appropriate trigger for Phase II relief for switched access services. *Id.*, ¶¶ 200-206.

25. The triggers that the Commission has adopted to date fall far short of meeting the four above-described methodological principles that must be applied to guard

(continued)

and Order and Notice of Proposed Rulemaking, *In the Matter of Expanded Interconnection With Local Telephone Company Facilities*, CC Docket No. 91-141, ¶¶ 164-215 (released October 19, 1992).

successfully against the exercise of market power by the ILEC in the future. *First*, the Commission does not require petitioning ILECs to produce specific, verifiable data demonstrating that they have satisfied the triggers. In fact, the Commission declined in the *Pricing Flexibility Order* to require the ILECs to submit any particular type of evidence in order to meet the applicable triggers. *Id.*, ¶¶ 121, 172, 178. Without such a requirement, ILECs will naturally attempt to present only the most general, and unverifiable, data to support their applications for pricing flexibility. And, in the case of the two applications for pricing flexibility that BellSouth has filed since the issuance of the *Pricing Flexibility Order*,⁸ I understand that this is precisely what has happened.

26. For example, as AT&T noted in its opposition to BellSouth's petition for pricing flexibility for special access services and dedicated transport, BellSouth relied on the revenue-based trigger as its basis for Phase II relief for the vast majority (more than 80 percent) of the MSAs that were the subject of that petition. However, the only revenue data that BellSouth provided to support its petition was for the entire MSA – not the wire center-level revenue data that both the Commission and the CLECs need to verify whether, as the Phase II trigger requires, the wire centers where CLECs purportedly have collocated account for the required percentage of revenues derived from those services in the MSA.⁹

27. Similarly, according to AT&T's opposition to BellSouth's petition for pricing flexibility for switched access services, BellSouth refused to supply AT&T with the aggregate number of collocators in each wire center listed in the petition, the number of UNE

⁸ BellSouth filed a petition for pricing flexibility for special access and dedicated transport services (CCB/CPD File No. 00-20) on August 24, 2000. BellSouth filed a separate petition for pricing flexibility for switched access services (CCB/CPD File No. 00-21) on August 28, 2000, and filed an amended petition on September 1, 2000.

⁹ See AT&T Opposition To BellSouth Petition For Pricing Flexibility For Special Access and Dedicated Transport, filed September 8, 2000, at 8-10.

loops that BellSouth claims are purchased by AT&T for each wire center that the petition identified as having an AT&T presence (by means of a switch, remote switch, and/or collocation), and the customer segments that (according to BellSouth) AT&T has targeted in each wire center. Such data, for example, would have enabled AT&T to determine whether the number of provisioned loops described in the petition includes loops provisioned to AT&T and to verify BellSouth's assertions regarding collocated facilities (including targeted customer segments) in wire centers where AT&T is claimed to be the sole collocator. By refusing to provide AT&T with the requested data, BellSouth made it impossible for AT&T to verify whether the petition accurately describes the extent of AT&T's collocated facilities, the number and locations of the loops that AT&T has purchased from BellSouth, and the types of customers to which AT&T offers service from specific wire centers.¹⁰

28. *Second*, the Commission's triggers do not require a showing that the ILEC has lost its market power with respect to each critical component of the access services for which price flexibility is being requested. The Commission explained that it was not imposing such a requirement because (1) "regulation imposes costs on carriers and the public, and the costs of delaying regulatory relief outweigh any costs associated with granting that relief before competitive alternatives have developed to the point that the incumbent lacks market power"; and (2) "non-dominance findings are neither administratively simple nor easily verifiable." *Id.*, ¶¶ 90-91.

29. The Commission's rationales are unpersuasive. Although regulation certainly imposes costs, the costs to purchasers of access services – and ultimately to the end-user customers of those businesses – resulting from premature deregulation can be quite high.

¹⁰ See AT&T Opposition To BellSouth Petition For Phase I Pricing Flexibility For Switched Access Services, filed (continued)

The Commission offers no basis for its assertion that the costs of delaying regulatory relief outweigh the costs associated with granting that relief before the ILEC lacks market power.¹¹ Furthermore, although issues relating to the effectiveness of competition may sometimes be complex, the Commission has resolved such issues on a number of occasions in the past – as it acknowledges. *Id.*, ¶ 90 & n.249. More importantly, without requiring a showing that the ILEC lacks market power over all inputs required to provide access services, there is no assurance that the ILEC will not engage in the anticompetitive activities that the Commission seeks to prevent.

30. Thus, the Commission established triggers that do not consider the extent of an ILEC's market power over each individual critical input for the access service involved. In the case of special access services and dedicated transport, the Commission did establish a separate trigger for channel terminations, correctly recognizing that this input requires separate consideration because of the higher investment required for channel termination and the current reliance by alternative providers on the ILECs' facilities for channel terminations. *Id.*, ¶¶ 102-103. The Commission's channel termination trigger, however, looks only at collocation in a percentage of wire centers in the MSA. The trigger does not measure investment by competitors in channel termination facilities; indeed, under this trigger, an ILEC could receive pricing

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September 18, 2000, at 8-9.

¹¹ At one point in its order, the Commission suggests that the costs of granting pricing flexibility relief without requiring a showing of lack of market power are not substantial because "If an incumbent LEC charges an unreasonably high rate for access to an area that lacks a competitive alternative, that rate will induce competitive entry, and that entry will in turn drive rates down." *Pricing Flexibility Order*, ¶ 144. This rationale ignores both the ability of the ILEC, through its market power, to deter entry through such practices as predatory pricing and the barriers to entry that exist, particularly entry barriers for alternative access providers that seek to provide service exclusively over their own facilities. Moreover, the Commission's rationale is inconsistent with its actions. If unreasonably high prices readily induce other providers to enter the market, the Commission could simply have deregulated pricing of access services unconditionally, without adopting any triggers requiring a showing of competitive activity.

flexibility for channel terminations in a situation where not a single competitor has built any channel terminations anywhere in the MSA.

31. The distinction between channel terminations and dedicated transport, however, constitutes the Commission's sole separation of critical inputs in the context of special access services and dedicated transport. For special access services other than channel terminations and for dedicated transport facilities, the Commission established a *single* trigger – even though, for example, dedicated transport services consist of entrance facilities, direct-trunked transport, and the flat-rated portion of tandem-switched transport. The trigger treats these services as if they constituted but one critical input subject to the same degree of competition, even though they obviously do not, as the Commission itself has admitted. See Forbearance Order ¶ 28. The fact that competition might exist for entrance facilities does not mean that competitive alternatives are available for interoffice transport channels.

32. Instead of reviewing the ILEC's lack of market power over critical inputs, the Commission's triggers for special access services and dedicated transport look at whether competitors have operational collocations in a specified percentage of wire centers or in wire centers accounting for a specified percentage of revenues. The Commission itself acknowledged the "shortcomings" of using collocation as a measure of competition, at least for channel terminations (given the current reliance of competitors on ILECs for channel terminations), but reasoned that collocation "appears to be the best option available to us at this time." *Id.*, ¶ 103.¹² This rationale is perplexing, because the number of wire centers in an MSA where competitors have collocated facilities provides no indication of the extent of the ILEC's market power over

¹² As the Commission recognized, the fact that a competitor has collocated in a particular wire center does not mean that the competitor itself has put channel termination in place to serve special access customers, rather than rely on the ILEC for channel termination facilities. *Pricing Flexibility Order*, ¶ 103.

the critical inputs needed to provide the service. Collocation cannot serve as a reliable measure of the extent of effective, facilities-based competition, because in most instances the collocating competitor is dependent upon the cooperation of the ILEC in order to provide service.

33. For switched access services, the applicable trigger for Phase I relief requires an ILEC to prove that competitors, in the aggregate, offer service “either exclusively or largely over their own facilities” to 15 percent of customer locations in the MSA. *Id.*, ¶¶ 108, 113. Although the trigger does not require proof that the ILEC lacks market power over each critical input needed to provide switched access services, a showing that competitors are providing such services *exclusively* over their own facilities would strongly indicate that the ILEC lacks market power over those inputs, at least in the area of the MSA where they offer service. However, the trigger does not go far enough. In the first place, as discussed more fully below, the 15 percent threshold is too low. The fact that competitors offer totally facilities-based service to such a small portion of all customer locations does not mean that the ILEC lacks market power over the inputs needed to provide switched access services to the *remaining* customer locations.

34. Furthermore, the Phase I trigger can be satisfied as long as competitors provide switched access services using their own switching and transport, even if they also use unbundled loops obtained from the ILEC. *Id.*, ¶ 113. As the Commission itself admitted elsewhere in the Pricing Flexibility Order, however, unbundled loops obtained from the ILEC cannot be treated as the competitor’s “sunk” facilities for purposes of the Commission’s analysis. As previously stated, an ILEC can exercise market power over an entire service as long as it has market power over *one* of the critical inputs needed to provide the service. The Phase I trigger is thus fundamentally flawed, because it allows pricing flexibility relief even when the

“competitors” allegedly offering switched access services are subject to exclusionary behavior and pricing as a result of their dependence on the ILEC for unbundled loops.

35. The failure of the Commission’s triggers to review the presence or lack of market power for each critical input or component of the access service is a serious deficiency. As long as any of these necessary inputs is not subject to potential competition, BellSouth and other ILECs will, absent regulatory restraints, be able to charge supracompetitive prices for access services. The evidence of record suggests, in fact, that many inputs required for the provision of access services are available only from the ILEC. For example, in the BellSouth region, AT&T makes REDACTED percent of its payments for channel terminations, and REDACTED percent of its payments for dedicated transport, to BellSouth.¹³ In defending the use of a collocation-based trigger, the Commission itself appeared to recognize that ILECs currently have market power over channel terminations in the provision of access services.¹⁴

36. Unless barriers to entry are extremely low, these facts suggest strongly that an overwhelming majority of special access customers are captive customers that could be charged unreasonably high rates if BellSouth’s petition for pricing flexibility for special access is granted. The available evidence, however, suggests that barriers to entry in the provision of many of these inputs are substantial. For example, the evidence suggests that the barriers to entry in the provision of LDCs – essentially local loops to large business customers – are high

¹³ See Declaration of Charles E. Stock filed this date as part of AT&T’s motion for a stay (“Stock Declaration”), ¶¶ 4, 8.

¹⁴ “[A] competitor collocating in a LEC end office continues to rely on the LEC’s facilities for the channel termination between the end office and the customer premises, at least initially, and thus is susceptible to exclusionary pricing by the LEC.” *Pricing Flexibility Order*, ¶ 103 (footnote omitted). Although the Commission stated that it “seems likely” that competitors would depend on ILECs for channel termination “only on a transitional basis and will eventually extend [their] own facilities to reach [their] customers” (*id.*, ¶ 104), the possibility that competitors might use their own facilities at some unknown future date does not alter the Commission’s basic conclusion that, currently, ILECs have market power over channel terminations.

enough to enable ILECs such as BellSouth to maintain a very high share of LDCs while charging already supracompetitive prices. As the Commission has recognized, new entrants in the BellSouth region face significant impediments to building LDCs and entering the market quickly. New entrants are charged rights-of-way fees by building owners that BellSouth was not (or is not) charged; new entrants are charged rights-of-way fees by municipal governments that BellSouth was not (or is not) charged, or are unable to procure such rights-of-way altogether; new entrants are forced to endure lengthy waits to get municipal rights-of-ways; in many existing buildings, there is simply no space (or power) for redundant facilities even if the building owner is otherwise willing to permit them; and many building owners will not permit AT&T and other prospective providers of special access to connect a customer to its network but instead require them to pay BellSouth for that work. Last, but definitely not least, LDCs are characterized by large fixed and sunk costs, thus limiting competition to only the extremely high-volume users.¹⁵

37. Dedicated transport facilities provide yet another example of inputs needed to provide special access services where barriers to entry are considerable. Although some competitors may have put in place dedicated transport facilities in some areas of the BellSouth region, the costs of deploying these facilities are sufficiently high so that it is economic for AT&T and other competitors to serve only the special access customers with the greatest demand.¹⁶

¹⁵ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order, 15 FCC Rcd. 3696 (¶¶ 182-87) (1999) (“*UNE Remand Order*”) (“as a practical matter, building loop plant continues to be, in most cases, prohibitively expensive and time-consuming,” and the fact “[t]hat some [CLECs], in certain instances, have found it economical to serve certain customers using their own [high-capacity DS1] loops suggests to us only that carriers are unimpaired in their ability to serve those particular customers”); *Promotion of Competitive Networks in Local Telecommunications Markets, et al.*, WT Docket No. 99-217, Notice of Proposed Rulemaking, 14 FCC Rcd. 12673 (¶¶ 21-24, 29-35, 52-63) (1999);

¹⁶ *UNE Remand Order* ¶¶ 355-56, 359. More precisely, although competitors have installed transport limited facilities at the DS3 level – the type of facilities for the largest special access customers – these facilities serve only
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